

Finance Minister's Speech

Global Cooperation on Sustainable Growth and Development: Views from G-20 Countries

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Dr. Isher Judge Ahluwalia, Chairperson ICRIER,
Dr. Parthasarathi Shome, Director and Chief Executive ICRIER
Distinguished Participant,
Ladies and Gentlemen,

It gives me great pleasure to join you at this international conference on 'Global Cooperation on Sustainable Growth and Development.' I understand that the conference has been organised around 5 broad thematic areas - global imbalances, financial regulation, international monetary system, development, and commodity markets. In each of these areas, the world is facing several immediate challenges and these issues are therefore the subject of ongoing discussions in the G 20. I congratulate ICRIER and its partners for organizing this timely conference and bringing together eminent academics and policymakers from across 14 countries, to deliberate on these critical issues.

2. The G 20 demonstrated its relevance to international policy making with the success of its coordinated response on the fall-out of the global financial crisis. The economic downturn was moderated and growth resumed in the second half of 2009 in most economies, although the pace

of recovery remained uneven. Advanced economies grew more slowly than before, while emerging economies like China and India ^{and} led the way, with Latin America and Africa following closely. It appeared that policy makers had learnt their lessons from history by honing and harmonising the use of macro-economic policy and keeping markets open. At the same time, countries in the developed and the developing world adopted revival strategies in keeping with the needs of their respective contexts.

3. Developments in recent months have been less encouraging. There is widespread apprehension that even the tepid global economic recovery that we have seen so far is stalling. Growth in most advanced economies has declined in the second quarter of 2011 and emerging markets are witnessing a combination of moderation in growth and rising inflation.

4. Advanced economies, the Euro zone and the US, are seized with sovereign debt problems. This is making financial markets nervous. Elevated fiscal deficits and public debt have always followed deep recessions in the past, which could be overcome with stronger recovery in output. In the present instance, the nominal output is yet to reach the pre-crisis levels. There are structural constraints coming in the way of advanced economies returning to their trend growth path. As a result, their fiscal position looks increasingly unsustainable. Despite the aggressive fiscal and monetary policy, unemployment continues to be at its highest in many advanced countries. The question is what more can policy makers do to improve growth or to avoid another downturn. While Europe has started fiscal tightening in response to an adverse market response, the United

States has recently announced another big fiscal stimulus, perhaps in the belief that there cannot be fiscal consolidation without growth.

5. Emerging markets recovered quickly from global slowdown, but are facing elevated commodity prices, inflation, moderating growth and volatile capital flows all at once. Central banks have been forced to raise policy rates repeatedly, potentially compromising growth in the short-term. They are also confronted with the impossible trinity. While raising rates may help stabilize growth, it may also invite more capital inflows. It is true that emerging economies are relatively better placed with regard to their public debt and fiscal deficit due to their stronger growth momentum and relatively robust banking systems. Their downside risks are on account of high oil and commodity prices and volatility in capital flows, partly due to the easy money policies in advanced countries.

Ladies and Gentlemen,

6. Unlike at the outset of the global financial crisis, when G 20 led policy coordination across economies could be achieved rapidly, it may be more difficult now. The advanced and developing countries are at different stages of the business cycle. It is important, therefore, to pause and think about what the G 20 agenda has been thus far and how it needs to evolve in future.

7. One of the central objectives of the G-20 has been to address the root causes of the global financial crisis, prevent a recurrence and, going forward, to take measures to achieve strong sustainable and balanced growth. Dealing effectively with the interrelated issues of global imbalances,

financial regulation, and the international monetary system are central to this agenda.

8. Most observers believe that the proximate cause of the recent crisis lay in a small, sub-prime segment of the US housing market. The ultimate reasons included the growing weaknesses in financial regulation and the build up of global imbalances. Since the international monetary system does not have an effective mechanism for preventing the build up of global imbalances, the G 20 took up the issue of its reform on a priority basis. There is an understanding that the G 20 Framework for Strong, Sustainable and Balanced Growth may be the mechanism for adjusting these imbalances. This work-stream, in which India plays an important role as co-chair of the Framework Working Group, is vital for the success of the G 20.

9. Strengthening domestic drivers of growth in developing and emerging economies is necessary for rebalancing of the global economy. As a result, the development agenda has become a central theme for the G 20 since the Seoul Summit. Moreover, as financial markets were seen to be destabilizing commodity markets, commodity price volatility and food security were also added to this agenda.

10. While welcoming these initiatives, we need to be cautious regarding the danger of working with a one-size-fit-all approach. Basel III is a good case in point. It is quite demanding on developing country banks. Different stages of economic development require different levels and quality of support from the financial sector. If capital adequacy standards become too high, there is a danger of inefficient dis-intermediation in markets. Emerging

markets should use prudential regulation and close supervision rather than merely high capital standards.

11. Global macroeconomic imbalances are at the heart of destabilizing sustainable economic growth at the international level. We know that all imbalances are not bad as some of them reflect multi-paced growth, different savings-investment behaviour and productivity levels across economies. Such differences may not be destabilizing per se. At the same time, some imbalances reflect structural inefficiencies usually created by policy distortions relating to the external sector, trade, capital flows and exchange rate policies, financial markets, tax and subsidy regimes, which have to be addressed.

12. The reform of the International monetary system is high on the agenda of the G-20 and various issues including capital flows management, financial safety nets, measuring global liquidity, composition of the SDR basket are currently under discussion.

Ladies and Gentlemen,

13. Let me take this opportunity to emphasise a few specific issues for your deliberations. An issue of immediate concern for emerging economies is managing large capital flows. Large and volatile capital flows to emerging markets can be destabilising as they lead to high exchange rate volatility and in some cases make it incumbent to maintain high levels of foreign exchange reserves as an insurance against sudden or large-scale flight of international capital. Large and volatile inflows are also associated

with asset price booms and encourage excessive risk taking by traders and investors and therefore threaten financial stability.

14. *Secondly*, recent commodity and food price rise and their volatility have induced considerable threat to economic growth and food security in energy dependent emerging, as well as, developing economies. Factors behind recent price hikes are yet to be pin pointed. Even the G-20 is undecided on the role of speculation and global excessive liquidity on the international commodity prices. Though it does seem odd that commodity prices should be so buoyant even as the outlook for global growth is weak. We need more research and debate on whether speculation in currency and commodity markets has been playing a role in recent price rises. If yes, how do we check it in the future without stifling the functioning of markets?

15. *Thirdly*, G 20 development agenda is understandably very vast. It covers areas that are also being handled by a number of developmental agencies. While we are committed to concerns of 'development' and of sharing the fruits of economic growth, it is imperative to prioritize among various development needs. One development issue that deserves priority is the recycling of global savings for infrastructure investment. Enhancing infrastructure investment in emerging economies and developing countries would have positive spin-off for rebalancing global demand. It would result in real investments with tangible growth. The G-20 is well placed to coordinate various stakeholders including governments, especially the ones that have large surpluses, the private sector, and multilateral development banks, for investment in developing economies. I hope the conference can suggest innovative ways to recycle global savings and identify viable

strategies to overcome the presumed hurdle of 'lack of enabling environment' for infrastructure investment in emerging and developing countries.

16. Even though there are no simple answers or magic solutions to some of these issues, I for one do not see any reason for despair. I am hopeful that your deliberations will help in addressing global challenges at the current conjuncture and also the structural problems that confront us all, in an innovative and cooperative framework. The need of the hour is global reforms with an eye on medium to long-term sustainability of economic growth. I wish you two very productive days ahead and I look forward to the outcome of your deliberations ahead of the next Cannes G20 Summit.

Thank you
